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Moody's: Subprime servicers modify only 1% of loans

Legislation that would allow bankruptcy courts to modify the terms of a homeowner's mortgage loan could save 600,000 homes from foreclosure, the bill's sponsor claims.

HR 3609, the Emergency Home Ownership and Mortgage Equity Protection Act of 2007, would repeal a legal provision that prohibits bankruptcy courts from modifying the repayment terms of home mortgages. Bankruptcy courts already have the power to modify payments on other secured debts, including mortgages on other properties.

"Responsible lenders who made loans on reasonable terms have nothing to worry about in bankruptcy court, but predatory lenders will end up with the loans they should have made in the first place," said bill sponsor Rep. Brad Miller, D-N.C., in a press release.

Miller introduced the bill Friday, with backing from the influential chairman of the House Financial Services Committee Chairman, Rep. Barney Frank, D-Mass.

On Monday, Moody's Investors Service released the results of a survey of subprime mortgage servicers, which found most servicers had modified only 1 percent of loans that experienced a reset in January, April and July.

"Despite much industry dialogue and heavy press attention on the topic of loan modifications as a mitigation technique to avoid foreclosure and reduce losses on defaulted loans, the survey results suggest that on average subprime servicers have only recently begun to materially increase the number of modifications as it relates to interest-rate resets," Moody's analysts said in releasing the survey's results.

In a study released in March, First American CoreLogic projected 13 percent of the 8.37 million adjustable-rate mortgages (ARMs) originated between 2004 and 2006 would default in the next six years, wiping out $112 billion in equity after homes securing $326 billion in loans are sold.

The study predicted the actual number of foreclosures would hinge on home prices, with each 1 percent decline in home prices putting another 70,000 homes into foreclosure.

Robert Shiller, a Yale professor who helped develop the Case-Shiller Home Price Index, testified before Congress this month that home prices have fallen by 6.5 percent since the peak of the housing boom, and that he expects them to fall another 7 to 13 percent by next August.

Moody's said that its survey revealed between 5 and 15 percent of adjustable-rate loans originated in early 2005 that were not modified became delinquent after their interest rates reset, and predicted that delinquencies will be higher on loans originated in late 2005 and 2006.

The ratings firm called on loan servicers to be more proactive in contacting borrowers facing resets, saying the majority of large servicers rely on the mail, when telephone calls would be more effective.

"Based on the survey results, Moody's is concerned that the number of modifications that will be performed in the future by subprime servicers on loans facing reset may be lower than what will be needed to significantly mitigate losses in subprime pools backing rated securitizations," Moody's analysts said. Moody's warned that it expects to issue downgraded ratings on more subprime residential mortgage-backed securities issued in late 2005 and 2006.

Countrywide Financial Corp. said Monday it is on target to modify nearly 25,000 mortgage loans in 2007, with 17,000 loans modified year to date.